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IN THE

Supreme Court of the United States

October Term 1970

No. 1493

VERNITRON CORPORATION and AMERICAN MEDICAL INSTRUMENT CORPORATION,

Petitioners,

against

PAUL BENJAMIN,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF

CHARLES H. MILLER
430 Park Avenue
New York, New York 10022
Attorney for Petitioners

MARSHALL, BRATTER, GREENE, ALLISON & TUCKER
430 Park Avenue
New York, New York 10022

ARTHUR J. GINSBURG
430 Park Avenue
New York, New York 10022
of Counsel

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REPLY BRIEF

Argument

Petitioners Vernitron Corporation ("Vernitron") and American Medical Instrument Corporation ("Amico") submit this brief in reply to the arguments asserted by Respondent Paul Benjamin ("Benjamin") that (i) the propriety of the preliminary injunction has been mooted by the vacation of the injunction and entry of judgment in the state court; and (ii) the reinstatement of the injunction would in some undefined way have a "catastrophic effect on federal-state relationships."

I.

The Petition is not Moot.

Respondent's argument that the petition has been mooted by the state court's entry of summary judgment is the culmination of respondent's most unfair attempt to capitalize on his own questionable conduct in obtaining the vacation of the injunction by the Hon. Morris E. Lasker in the District Court without notice to the petitioners and without disclosure to the District Court of the petitioners' announced intention promptly to seek review of the Second Circuit's decision by this Court. Indeed, respondent's questionable procedure led the State Court, which entered judgment, to find erroneously that this Court in fact had denied certiorari. A copy of the written decision of Justice Nathaniel T. Helman of the New York State Court, dated April 6, 1971, rejecting Vernitron's motion for rehearing and renewal of Benjamin's motion for partial summary judgment is annexed hereto.

Justice Helman's refusal to reconsider—even in the face of substantial allegations and evidence of fraud, misrepresentations, and nondisclosures of material facts—Vernitron's assertion that partial summary judgment should not be granted to respondent without a trial of the issues is not an event which has permanently altered Vernitron's substantive rights in either the state or federal action. There has been no ouster of federal jurisdiction resulting from the entry of the state court judgment. All there has been thus far is some substantiation for petitioners' fears that the federal action may at some future date be dismissed on respondent's motion if and when he can show to the satisfaction of the District Court that petitioners' federal action is barred by the doctrine of collateral estoppel or *res judicata*. Such a determination has not yet been made or even entertained.

Hence, contrary to the decision of *Brownslow* v. *Schwartz*, 261 U.S. 216 (1923), cited by Benjamin, the in-

stant petition is not mooted by reason of events occurring subsequent to the decision of the Circuit Court. In *Brownslow* this Court determined that the completion of a building operated to destroy the relief sought in the litigation and the writ was accordingly mooted. Nothing so drastic has occurred here, however, in either the state or federal action which could operate to render ineffectual any judgment of this Court.

What has occurred is the following:

On April 8, 1971, a judgment was entered against Vernitron for in excess of $1 million, but the execution of that judgment has been stayed temporarily. Assuming it is determined by this Court that the Second Circuit's reversal of Judge Lasker's decision was improper, this Court could order the Second Circuit to reinstate the injunction and thereby stay execution of the state judgment pending the disposition of the federal proceeding. Furthermore, it is also within the power of this Court or the Second Circuit to order Banjamin to vacate his judgment in the state court action. This, obviously, would be the most appropriate remedy to fashion under these unusual circumstances as it would remove the possibility of petitioners' being precluded from litigating their exclusively federal securities law claims in the federal court.

Vernitron intends to appeal promptly to the Appellate Division of the Supreme Court of the State of New York, First Department, and, if necessary, to the New York Court of Appeals, to seek review of Justice Helman's novel decision that misrepresentations as to the earnings of an on-going business are irrelevant to a purchaser's action for damages and/or rescission. Assuming that Vernitron is successful in its state appeal, there would be no possibility of any *res judicata* or collateral estoppel effects which would inhibit the prosecution of the federal action.

In short, the entry of the state court judgment against Vernitron has done no more than to permit Benjamin to move one step closer to closing the door on petitioners' right to *one trial* of its Securities Act claims. The entry of the state court judgment cannot render this appeal moot until the federal doors are finally closed to Vernitron and Amico.

II.

The Reinstatement of the Injunction will not Adversely Affect Federal-State Relations.

In his effort to avoid at all costs *one trial* of the issues between the parties, Benjamin has resorted to the argument that any action by the federal courts to assert their exclusive jurisdiction to determine claims arising under the federal securities laws and to fashion an appropriate remedy under those laws would in some undefined way have a "catastrophic effect on federal-state relations." Such an argument is without basis, and overlooks entirely the particular facts of the instant case, which the District Court properly grasped.

The simple facts are that Benjamin expressly represented and warranted in the Agreement and with the customary and usual form required in a securities transaction, the Balance Sheet, *and the earnings statements of Amico.* Asserting that there had been substantial misrepresentations as to the earnings statements, and that the acquisition had been made, as respondent well knew, upon a multiple-of-earnings formula which is standard and accepted in the investment community, Vernitron refused to register for public sale and distribution the shares of Vernitron common stock acquired by Benjamin through his alleged securities fraud. The only "breach" charged to Vernitron is its refusal to act as a conduit in Benjamin's scheme to defraud the public.

In the State Court action which Benjamin commenced, he moved for partial summary judgment. New York Civil Practice Law and Rules § 3212(e) provides that a motion for partial summary judgment "shall be denied if any party shall show facts sufficient to require a trial of any issue of fact other than an issue as to the amount or extent of damages." Accordingly, the State Court undertook to analyze Vernitron's counterclaims, including the counterclaim for rescission rooted in Section 29(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78cc(b). Justice Helman refused as a matter of *state law* to recognize Vernitron's claims as to Benjamin's misrepresentations with respect to Amico's earnings; and he thereupon determined *upon the pleadings* that the Balance Sheet discrepancies of some $43,000, were, on a dollar-for-dollar basis, the maximum recovery available to Vernitron for Benjamin's misrepresentations. Incredible as it seems, such a holding was rendered despite the fact that the entire Balance Sheet value (net worth) of Amico, at the time Vernitron agreed to acquire the business for $1,500,000, was only $300,000.

The State Court was induced by respondent to reach this clearly erroneous result because Justice Helman was convinced that "Defendant [Vernitron] has selected the Federal Court as his forum for the determination of the S.E.C. questions involved, and will not be prejudiced in that regard *by the present determination.*" In fact, as all four federal judges who have heard argument with respect to this case have indicated, the "Balance Sheet" test applied by Judge Helman may well become, if permitted to stand, the law of the case, and Vernitron will be estopped collaterally from proving the misrepresentations and nondisclosures relating to Amico's earnings. The "Balance Sheet" test may also become a precedent and battle cry for securities act violators who are anxious to avoid the force and effect of the provisions of the securities acts and the scrutiny of the federal courts.

Virtually every securities seller or purchaser who can establish a touchstone of jurisdiction in the State of New York, home of the two principal stock exchanges, will be able to invoke the provisions of the partial summary judgment procedure whenever the other party has refused, on the grounds of alleged securities act violations, to fully perform contracts involving the purchase or sale of securities.

In short, it is not the State Court's fact-finding process which would be challenged by the grant of injunctive relief, but, rather, its refusal to permit Vernitron to invoke the time-honored fact-finding processes with respect to its claims that the earnings misrepresentations made by Benjamin unlawfully induced Vernitron to enter into the Agreement. Succinctly framed, approbation of injunctive relief in the instant case need only instruct state forums that the mere existence of a state created procedure, such as the partial summary judgment procedure, does not and cannot be used to permit a state court to determine summarily claims arising under the securities acts for which exclusive jurisdiction has been vested in the federal courts. *cf. Wellington Computor Graphics, Inc.* v. *Modell*, 315 F. Supp. 24 (S.D.N.Y. 1970). It was only because the spectre of such an application of the New York partial summary judgment procedure was at hand, that Vernitron sought to stay the proceedings pending before the state court.

CONCLUSION

For the reasons set forth above, a writ of certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

CHARLES H. MILLER
430 Park Avenue
New York, New York 10022
Attorney for Petitioners

MARSHALL, BRATTER, GREENE,
ALLISON & TUCKER
430 Park Avenue
New York, New York 10022

ARTHUR J. GINSBURG
430 Park Avenue
New York, New York 10022
of Counsel

Decision of Helman, *J.* of April 6, 1971

SUPREME COURT

NEW YORK COUNTY

SPECIAL TERM—PART I

Index No. 8753—1970

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PAUL BENJAMIN,

Plaintiff,

against

VERNITRON CORPORATION, AMERICAN MEDICAL INSTRUMENT CORPORATION, and MARSHALL, BRATTER, GREENE, ALLISON & TUCKER, in its capacity as Escrow Agent,

Defendants.

———o———

HELMAN, J.:

Under the terms of a contract of sale, dated December 20, 1967, plaintiff agreed to sell to defendant all of its "assets, properties, business and good will" for the sum of $1,500,000. Payment was to be made in stock of the Vernitron Corp., with leave to the seller to periodically require registration of various amounts of stock so that shares might be sold on his behalf. Charging a breach of this obligation to register with the SEC, plaintiff brought this action and was granted summary judgment in the amount of approximately $1,000,000, leaving open for trial a claim of approximately $40,000.

Attempts by defendant to stay the determination of the summary judgment motion by proceedings in the Federal Court were initially unsuccessful. The Federal Court action, instituted some six months after the filing of the

answer in this action, was predicated upon an alleged violation of the SEC Act of 1934, and was based upon broad allegations of fraud and concealment by this plaintiff. Following the granting of summary judgment to plaintiff in this court, defendant obtained in the Federal Court a preliminary injunction against any further prosecution of this action. On appeal to the Circuit Court of Appeals, the preliminary injunction was thereafter vacated, and a subsequent petition to the United States Supreme Court for a writ of certiorari brought by defendant denied, thus freeing the pending proceeding from further restraints.

Defendant now moves for a rehearing and renewal of plaintiff's motion for summary judgment, pursuant to rule 2221 of the CPLR, upon affidavits alleging the discovery of new evidence not previously available to defendant, supportive of defendant's counterclaim for rescission. Explanations are offered by defendant for its delay of three years in uncovering some of the alleged misrepresentations and concealments of the plaintiff, but they lack persuasiveness and even logic. Defendant, in its Federal Court actions, had ample opportunity by depositions to obtain complete disclosure of the subject matter of these charges, and even the most cursory examinations of records of plaintiff's dealings with the U. S. Contracting Division would have provided defendant with all of the information it sought. Additional allegations of fraudulent concealment relating to the chrome-plating of scissors are unimpressive, for defendant has had possession of those items for three years and with the slightest effort could have obtained all of the information relating thereto at or before making its purchase. The whole area of "non-disclosure" on which defendant relies, belies the express language of the firm written contract of the parties, and involves nothing more than a dissatisfied buyer who three years later regrets his purchase.

Nevertheless, because of the substantial amounts involved, the court has examined in detail the claims of de-

fendant with a view to determining whether real issues are here presented, and whether a trial of the factual questions raised by defendant is required in the interests of justice. Essentially, what is presently alleged has been the subject of prior consideration by the court. Defendant asserts that it relied strongly on plaintiff's representations as to earnings and income, and that it based its original offer on a "multiple of earnings" formula. The contract of sale, however, prepared by skilled attorneys, dealt with a sale of "assets, properties and good will" and contained no representations as to earnings which might be used as a basis for a multiplication formula. Instead, the language of article V, subdivision 111, refers to earnings as disclosed by the books and records, and in customary language, states that they are "true and correct and present fairly its financial condition and the results of its operations." At best, defendant's use of a "multiple of earnings" theory was its own choice of a method of appraisal and plaintiff is certainly not bound thereby. That buyer chose to use 10 times earnings as a method of evaluation, did not mean that a seller could not fix his price in his own way, particularly, where, as here, no representations were made.

The fact that occasional differences arose between the U. S. Defense Supply Agency and the plaintiff, prior to the sale, concerning quality and performance does not provide defendant with claim of "concealment" available in support of its "rescission" counterclaim. These were insubstantial matters, and as appears from the Agency's letter of February 19, 1971, in no way affected the business relationship between the parties; in fact, the company, under defendant's control, presently engages in business with the Agency. It is to be noted that no claim has ever been asserted by the United States Government arising out of these contracts, and three years having passed, it is difficult to understand how defendant could have sustained any damage from this alleged concealment. If defendant

has suffered a reduction in awards of government contracts during the three years of its operation, it offers no evidence that such reductions were occasioned by the derelictions of the plaintiff previous to the transfer of its business. Indeed, the affidavits of defendant are replete with generalizations and liberal uses of the word "fraud", but the same affidavits lack factual matter from which the court can draw an inference of substantial damage resulting from any misrepresentation by plaintiff. In essence, plaintiff warranted nothing more than the computations reported on its balance sheets as prepared by the accountant for the selling corporation, and a falling off of business following the sale may not properly be attributed to the plaintiff. A further attempt to make use of a broker's memorandum, unsigned, and recently discovered, is likewise of little significance in demonstrating that issues exist requiring trial. Defendant has selected the Federal Court as his forum for the determination of the S.E.C. questions involved, and will not be prejudiced in that regard by the present determination.

On the whole, defendant has failed to demonstrate a sound basis for a reconsideration of the prior holding of the court, and its application will in all respects be denied.

Dated, April 6th, 1971

Order Signed

/s/ N T H
J. S. C.

(Filed April 6, 1971
New York Co. Clerk's Office)